Supplemental Report

By the

Historic Tax Credit Committee

Tax Credit Review Commission

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Committee Members

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HISTORIC PRESERVATION TAX CREDIT

The Tax Credit Review Commission reviewed the Missouri Historic Preservation Tax Credit program, found at Section 253.545 et seq., RSMo.

Background

The Missouri Historic Tax Credit Program was created in 1997 by the General Assembly and the program became effective January 1, 1998 for the purpose of providing an incentive for the redevelopment of commercial and residential historic structures in Missouri. DED administers the Program and is responsible for the issuance of all tax credits based upon final certification of the rehabilitation project by the Missouri Department of Natural Resources, State Historic Preservation Office ("SHPO").

The last four Fiscal Years have seen the following use of the Program:

FY 2009	
Authorized	$211,950,941
Issued	$119,914,948
Redeemed	$186,426,164
FY 2010	
Authorized:	$99,510,175
Issued:	$107,229,218
Redeemed:	$108,064,200
FY 2011	
Authorized:	$82,839,495
Issued:	$116,244,410
Redeemed:	$107,767,393
FY 2012	
Authorized:	$98,591,346
Issued:	$105,272,651
Redeemed:	$133,937,747

Renovation of historic structures positively impacts local tax collections from property, sales, and income taxes, and benefits an area from increased attractiveness, further investment and, lower crime rates related to higher-visibility/higher use areas.

The Program was designed to provide state tax credits equal to 25% of eligible costs and expenses of the rehabilitation of approved historic structures. An eligible property must be (i) listed individually on the National Register of Historic Places, or (ii) certified by the Missouri Department of Natural Resources as contributing to the historical significance of (a) a certified

historic district listed on the National Register, or (b) a local historic district that has been certified by the US Department of the Interior. Eligible costs include, but are not limited to, qualified rehabilitation expenditures ("QREs") as defined under the federal program. Generally, improvements made within the "footprint" of the building are eligible if they are permanent. Soft costs directly related to the rehabilitation, such as architect's fees, are also allowed. To qualify for credits, however, QREs associated with the rehabilitation must exceed 50% of the total basis of the property (i.e. the acquisition cost).

The tax credits issued under the Program can be applied to state income taxes (excluding withholding taxes) under Chapter 143 and to taxes under Chapter 148, including the Bank Tax, the Insurance Premium Tax and the Other Financial Institution Tax. Any taxpayer is eligible to participate in the Program. Not-for-profit entities and government entities are ineligible. Tax credits must be used first in the year they are issued. If there is any excess, they may be carried back to any of the three (3) preceding years and carried forward for the succeeding ten (10) years. Tax credits may also be sold or transferred in accord with Missouri law.

In 2009, the General Assembly passed House Bill 191 (2009) and made significant changes to the Program in an effort to address growing concerns over the fiscal impact of the Program on the state budget. These changes imposed new annual limits on the amount of tax credits approved by DED. As of January 1, 2010, there is an initial program cap of $70 million for projects receiving tax credits over $275,000. Effective as of July 1, 2010, the annual cap became $140 million for projects receiving tax credits over $275,000. Owner-occupied residential projects have a per-project cap of $250,000 in tax credits. Any project, other than these owner-occupied residential projects, receiving less than $275,000 in tax credits are completely exempt from the program caps.

House Bill 191 also established a more detailed, multi-step application and approval process. The process now requires that applicants submit preliminary applications to DED detailing the project, which may be completed in multiple phases, and expected costs. Such preliminary applications are prioritized by DED according to the date of submission. Upon review of the application by SHPO, DED then reviews each application to determine whether all required information is included. If the application is complete, DED will approve the application and notify the applicant in writing of the approval for a specific amount of tax credits. DED provides preliminary approvals according to the priority of applications and only to extent that tax credits are still available for authorization under the annual cap. In the event that all tax credits available under the annual cap are approved by DED in a given year, pending applicants are notified and those applications are kept on file to be considered for approval of tax credits when credits are next made available (either in the next year or sooner if prior approvals are rescinded and those approved credits are again made available for approval). It is worth noting that this preliminary approval is merely a notice that the project is preliminarily authorized to receive tax credits. This

is different from the tax credits being issued upon final approval, and later redeemed with the state. These preliminary approvals of tax credits are the basis for calculating the annual cap for the Program.

Upon preliminary approval of an application for tax credits, applicants must commence rehabilitation not more than two (2) years from the date of approval. When the rehabilitation project is completed and expenses have been paid, a final application is submitted to DED along with expense documentation known as a "cost certification." After the final application is received by DED, SHPO performs a final review of the technical project work and DED performs an audit of the cost certification. DED also charges a fee of 2.5% of the amount of tax credits issued. Upon final approval of the project work and expenses, and once the issuance fee is paid to DED, a tax credit certificate for 25% of qualified rehabilitation expenditures is issued and mailed to the applicant by DED in the final year that QREs were incurred or within the twelve (12) month period immediately following conclusion of the project. Currently, applicants may not receive tax credits for rehabilitation expenses incurred prior to receipt of the preliminary project application by DED.

Endorsements

1. The Committee endorses the decision of the Global Issues Committee to eliminate sunset provisions from all tax credit programs. The Historic Preservation Tax Credit, in particular, requires business certainty on behalf of developers, investors and lenders due to the long "lead time" necessary to acquire, finance and develop projects benefiting from the Program.

Recommendations

1. The Committee recommends beginning on July 1, 2013, the Historic Tax Credit program's annual cap be reduced from $140 million to $90 million per year.

2. The Committee recommends that transition rules be adopted for implementing the recommended cap reduction so as to recognize the Governor's admonition that the Commission's recommendations should "do no harm" to projects currently underway. Considering the length of time and expense involved in getting applications to the point of submittal as well as the difficult economic climate such rules should ensure that all existing projects that have submitted their complete preliminary application to DED prior to December 31, 2013 proceed under the current cap rather than the new cap. Because of the time involved in applying to the required historic register, for purposes of this transition, complete preliminary applications would not require historic designation. This also would be consistent with current law which allocates credits to a project based upon the application submission date, not the preliminary approval date. Projects that are submitted, but not yet approved, would be "grandfathered" in recognition that they have

already incurred considerable expense, legal liabilities and potential eligible rehabilitation costs.

3. Any taxpayer applying for tax credits after December 31, 2013 would be subject to the new $90 million annual cap.

4. The Committee recommends that the residential (non-income producing) purchase price limitation be $250,000 instead of the 2010 recommended $150,000.

5. The Committee recommends that the General Assembly prohibit the stacking of Historic Tax Credits with Neighborhood Preservation Tax Credits.

6. The Committee recommends that the General Assembly allow the use of the State Low Income Housing Tax Credit and the State Historic Preservation Tax Credit in the same project (anti-stacking), except on housing projects using the tax exempt bond only (without the State Low Income Housing 4% Tax Credit program) and further recommends that the amount of State Historic Tax Credits used on such projects be included in calculating the new $90 million annual cap recommended on the State Historic Tax Credit program. As described in greater detail elsewhere in this report, the Commission has made a corresponding recommendation with respect to the Low Income Housing Tax Credit. The Committee also recommends that the percentage of the total QREs of an eligible project for which State Historic Preservation Tax Credits may be claimed would be reduced from the current twenty-five percent (25%) to fifteen percent (15%) for any project also receiving State Low Income Housing Tax Credits for approximately 9% of the eligible development costs.

7. The Committee recognizes the importance of the use of taxpayer dollars on eligible and paid expenditures. The Committee recommends that the developer fee be allowed to be accrued and eligible as a Qualified Rehabilitation Expense as long as the payment is made within a 6 year period.

8. The Committee acknowledges the administrative efficiencies discussed and recognizes that the Department of Economic Development intends to consider and meet with any and all interested parties regarding the suggested efficiencies. Of those suggested administrative efficiencies, the Committee specifically recommends the following:

    a. The “small deal” exemption in Section 253.550.2 should remain in place for certain small projects which do not receive more than $275,000 in State Historic Preservation Tax Credits, and the total amount of credits issued to such projects should continue to be excluded from the calculation of the annual cap.

b. The Department of Economic Development, within three (3) months after receipt of (i) an applicant's complete application for final approval and tax credit issuance and (ii) confirmation that the completed rehabilitation meets the standards of the Secretary of the United States Department of the Interior for rehabilitation as determined by SHPO, should issue such taxpayer an initial tax credit issuance in an amount of not less than seventy-five percent (75%) of the total amount of credits for which the applicant is eligible, as certified in the cost and expense certification. The Department of Economic Development's final approval and issuance of the remaining credits for which the applicant is eligible should occur within the twelve (12) months following any initial tax credit issuance as described above.

c. Missouri's definition of QREs uses the federal definition as a baseline, and permits certain other expenses to qualify. The precise list of QREs used by the Department of Economic Development should be revised to ensure it corresponds to the federal definition. Even with such revisions, the Department of Economic Development should retain discretion in assessing the qualifications of such additional QREs, particularly in the key areas of accruals, deferrals, and developer's fees. Moreover, the Department of Economic Development should continue to require audits, where applicable under current law, and to verify that all qualifying expenses have been incurred before any tax credits are issued.

9. The Committee also recommends that the General Assembly consider making the following statutory changes:

    a. Missouri should follow the federal "sixty (60) month rule" for phased projects when considering rehabilitation costs as a percent of the total basis of the property.

    b. Missouri should allow 501 (c) 3 non-profit organizations to be eligible for Historic Tax Credits if they are a 1% or less General Partner.

    c. Eligible applicants should be permitted to incur qualifying expenses, at their own risk, from submission of the application. However, the owner may, at its own risk, incur qualified rehabilitation expenditures prior to submission of the application that are limited to architectural, engineering, land surveyor fees, and other related soft costs necessary to prepare the application and rehabilitation plan and completion of the application to the required historic register, in addition to any hard costs incurred within (1) year prior to submittal of the application that are

related to the protection of the qualified structure from deterioration. Additionally, an applicant should be allowed to commence construction on a project and incur qualifying expenses, at their own risk, before the project is listed on the required historic register. If a project is ultimately approved, expenses are verified, and the work is certified as having been performed in accord with historic standards, the applicant should then be eligible to receive tax credits for all qualifying expenses, including those expenses incurred prior to listing in the required historic register.

In addition, the Department of Economic Development is required to issue tax credit certificates in the final year that QREs were incurred or within the twelve (12) month period immediately following conclusion of the project. This timeline should be extended in thirty (30) day increments upon the mutual agreement of the Department of Economic Development and the taxpayer to better allow parties to verify supporting documentation and cost data in good faith.

d. The Department of Economic Development currently interprets that portion of the historic tax credit statute which lists the prerequisites for a preliminary approval of an application to require a number of items which many believe should not be interpreted as contingencies to allocation of credits. For example, the Department of Economic Development now requires approval of a project by SHPO prior to preliminary approval of an application and allocation of credits.

   It should be clarified that review and approval of a project by SHPO is not a prerequisite to allocation of credits of an application by the Department of Economic Development. To this end, the list of items required for preliminary approval could be revised to more accurately reflect only those materials which are vital to assessment of an application for allocation of credits prior to preliminary approval.

e. A formal and public appeals process should be established for applicants whose submissions, at any stage, have been officially denied by either the Department of Economic Development or SHPO. Such appeal should be heard by parties not involved in the original denial.